

This letter responds to an annual survey. See 86 Ill. Adm. Code 130. (This is a GIL.)

August 26, 2003

Dear Xxxxx:

This letter is in response to your letter dated May 15, 2003. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found on the Department's Internet website at <http://www.revenue.state.il.us/Laws/regs/part1200/>.

In your letter, you have stated and made inquiry as follows:

AAA, in conjunction with FIRM, annually undertakes a major information collection effort with respect to the application of the tax laws of the states. AAA's goal in gathering this information is to assemble and publish the *PUBLICATION*. As the market has shown, such a publication is a useful reference source for government, industry, and public accounting.

AAA is in the process of updating the *PUBLICATION* for its 2004 annual edition. Accordingly, we ask for your state's assistance in preparing this important publication. Enclosed is the complete 2003 questionnaire and the complete 2002 (this year's) questionnaire with new questions highlighted in bold. (If you would prefer to complete the 2003 questionnaire electronically, we could email the entire questionnaire to you in a Microsoft Word file. To request an electronic version of the questionnaire, please email me.) Those of you completing only the Income Tax or the Sales Tax portion of the questionnaire should disregard the section that is not pertinent.

This year, the numbering scheme and the sequence of the questions remains essentially the same. Therefore, it should be easy to track your responses from last year. This year, to hold down our production costs, we have decided to not send everyone a copy of their prior year's responses. However, if you need last year's response in order to complete this year's questionnaire, please let me know. If so, I will forward it to you. Recognizing that the workload in many state departments of revenue may be excessive because of budget constraints and legislative proposals to deal with the state financial crisis, this year we are requesting that you only complete the new questions and any other questions that require update or change from last year. Hopefully this exception reporting approach will allow you to complete the questionnaire in an efficient and timely manner. Of course, if you would prefer to complete the entire questionnaire that would be fine as well.

Please complete the 2003 questionnaire as outlined above and **return it by July 18, 2003**, either in the self-addressed envelope that we have included to facilitate your reply or via email if you chose to work with the electronic file this year. If you choose to return it via US mail, either use the enclosed envelope or address your envelope to:

ADDRESS

The enclosed questionnaire should be answered in accordance with laws in effect as of July 1, 2003. If there is legislation pending or recently enacted that would alter your answers, please explain any such changes that you are aware of at the time the questionnaire is completed.

Beginning in the fall 2000, AAA initiated a tuition assistance program for state department of revenue employees in appreciation for the assistance in publishing the *PUBLICATION*. A limited amount of tuition assistance is available for courses in AAA's Graduate Certificate State and Local Taxation. This Certificate program is the first of its kind in the nation to be offered totally online. To receive the Certificate, students must complete the four-course curriculum. For further information about the program or available tuition assistance, AAA.

If you have any questions, please contact me. Thank you for your continued cooperation and support. Your contributions are extremely valuable in maintaining the quality of this outstanding reference work. A complimentary copy of the 2004 *PUBLICATION* will be sent to you when it is published next year.

DEPARTMENT'S RESPONSE:

III. SALES AND USE TAXES

A. Compliance and Administration

Regarding Question 1: The State of Illinois' Retailers' Occupation Tax rate is 6.25%. The Use Tax rate is 6.25%. Retailers in Illinois must collect the Use Tax from their customers by adding the tax to the selling price of the items being sold. See 86 Ill. Adm. Code 150.401. It is unlawful for any retailer to advertise or hold out or state to the public or to any purchaser that he will assume or absorb the tax. See 86 Ill. Adm. code 150.515(a). Local sales and use taxes have been adopted in the State of Illinois. Please see the Sales Tax Rate Reference Manual and 86 Ill. Adm. Code Parts 220, 270, 320, 370.

Regarding Question 2: Whether or not an organization or entity qualifies for exemption from federal income tax under Section 501 of the Internal Revenue code is not determinative as to whether it is exempt from Illinois Sales and Use taxes. Organizations that make application to the Department and are determined to be exclusively religious, educational, or charitable, receive an exemption identification "E" number. See 86 Ill. Adm. Code 130.2007. This number evidences that this State recognizes that the organization qualifies as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of its organizational purpose. Organizations that are exempt under federal income tax law are not automatically exempt under Illinois tax law. Sales to a governmental body are generally subject to tax unless the governmental body has an active exemption identification "E" number. See 86 Ill. Adm. Code 130.2080. However, Illinois retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its agencies without requiring an Illinois exemption number. When making a purchase, the holder of the card presents it to the retailer, who records the card number instead of collecting tax. If an organization or

governmental body does not have an "E" number, then its purchases are subject to tax. Please be aware that only sales to the organization or governmental body holding the "E" number are exempt, not sales to individual members of the organization. Companies must retain a Certificate of Resale or be provided with an "E" number for a sale to an organization or governmental body to be tax exempt.

Regarding Question 3: For information regarding the taxation of items purchased by a government employee while on government business, please see 86 Ill. Adm. Code 130.2080, 480.101, and 480.105.

Regarding Question 4: Taxpayers must file Form ST-1 to report both Retailers' Occupation Tax and Use Tax with the Department of Revenue, Springfield, IL. The Department does accept reproductions of the ST-1 if prior approval is received and the form is computer generated. Taxpayers cannot receive an extension of time to file the return. Taxpayers with multiple locations must file a Multiple Location Schedule form ST-2. See 86 Ill. Adm. Code 130.530. If a taxpayer terminates or ceases to do business a final return with payment of the tax due and payable is required. See 86 Ill. Adm. Code 130.520.

Generally payment of the tax is due when the return is due. See 86 Ill. Adm. Code 130.535. However, taxpayers with very large average monthly liabilities are required to pay quarter-monthly.

The State of Illinois has both a mandatory and a voluntary EFT (electronic funds transfer) program that allows both debit method and credit method transfers. Taxpayers must receive prior approval to participate in the voluntary program. Prompt payment discounts are allowed when a return is filed and the tax is paid on time. The retailer is entitled to a discount equal to 1.75% of the tax due. See 86 Ill. Adm. Code 130.501(f)(4).

Illinois does have a direct payment permit program. See 86 Ill. Adm. Code 130.2500 through 130.2535.

Illinois does not provide for internet filing of sales and use tax returns. However, the Department has created a voluntary electronic filing program. See 86 Ill. Adm. Code 760.100. Under this program, Form ST-1 Sales and Use Tax Return and Form ST-2 Multiple Site Form may be transmitted electronically. 86 Ill. Adm. Code 760.100(c).

ST-1 Sales and Use Tax Returns are due on or before the 20th day of the month for liabilities incurred in the prior calendar month for monthly filers. If a retailer's average monthly tax liability to the Department does not exceed \$200, the Department may authorize his returns to be filed on a quarter annual basis, with the return for January, February and March of a given year being due by April 20 of such year; with the return for April, May and June of a given year being due by July 20 of such year; with the return for July, August and September of a given year being due by October 20 of such year, and with the return for October, November and December of a given year being due by January 20 of the following year. Illinois law does not provide for a semi-annual filing of sales and use tax returns. If a retailer's average monthly tax liability does not exceed \$50, the Department may authorize his returns to be filed on an annual basis, with the return for a given year being due by January 20 of the following year.

Regarding Question 5: The statutory time limit for assessing sales tax in Illinois is found in Sections 4 and 5 of the Retailers' Occupation Tax Act which set out the limitations periods for issuance of Notices of Tax Liability to retailers. See 35 ILCS 120/4 and 120/5. Section 12 of the Use Tax Act incorporates certain Sections of the Retailers' Occupation Tax Act, including the limitations provisions provided in that Act. See 35 ILCS 105/12. Please note that these limitation provisions run from the date that the tax is due rather than from the date the gross receipts are received.

The 3 to 3 1/2 year limitations period described in 86 Ill. Adm. Code 130.815, is only for those taxpayers that have filed returns (except for fraudulent returns) for the periods in question. If the taxpayer is a non-filer for the periods in question, assessments for Retailers' Occupation Tax may be issued for periods as far back as July 1, 1981. If the taxpayer is a non-filer for the periods in question, the limitations period for Use Tax is 6 to 6 1/2 years (effective September 16, 1994). In the case of taxpayers filing fraudulent returns, no limitations period exists.

Taxpayers have 60 days after the issuance of a notice of tax liability to request an administrative hearing. A jeopardy assessment can be made relative to the sales tax. If the state receives a delinquent payment from the taxpayer, the payment is first applied to the tax, then to penalty and interest. In both non-audit and audit situations, Illinois must be notified, on Form IL 2848, that an individual will be acting on behalf of a corporate taxpayer.

Regarding Question 6: Taxpayers with a monthly average tax liability of less than \$50 may file annual returns upon authorization of the Department. Taxpayers with a monthly average tax liability of less than \$200 may file quarterly returns upon authorization of the Department. All other taxpayers must file monthly returns with the Department. Inactive sellers must file a return even though no sales are made during the return period. See 86 Ill. Adm. Code 130.545. Inactive sellers can cease filing returns after they file the businesses' final return pursuant to 86 Ill. Adm. Code 130.530.

Regarding Question 7: Please see 86 Ill. Adm. Code 700.200 through 700.230 and 700.300 for information regarding penalties and interest in Illinois. Please note that some these provisions were affected by P.A. 93-0032. See P.A. 93-0032. In addition, P.A. 93-0032 imposes a new collection penalty in Illinois. The collection penalty is applicable to any liability for tax, penalty, or interest, that relates to a return due on or after July 1, 2003. The penalty is imposed where an applicable liability is not paid in full within 30 days of the date printed on an assessment. The penalty is \$30 if the unpaid amount is less than \$1,000, and is \$100 if the unpaid amount is \$1,000 or more.

Regarding Question 8: A seller may deduct from his gross receipts any refunds made by him during the preceding return period to purchasers, on account of tangible personal property returned to the seller, in case the seller had theretofore included the receipts from the sale of such tangible personal property in a return made by him, and had paid the tax imposed by the Retailers' Occupation Tax Act with respect to such receipts. However, if the seller collected the Use Tax on such a sale, he should refund such tax to his customer to whom he makes a refund of the selling price. See 86 Ill. Adm. Code 130.401.

Regarding Question 9: If sellers make no taxable sales (i.e., all sales are sales for resale), those sellers need not register or file returns. Sellers who make no taxable sales can apply for resale numbers that do not require the filing of returns but give the wherewithal to provide suppliers with valid certificates of resale. See 86 Ill. Adm. Code 130.1415.

Whether retailers' contact with Illinois results in nexus depends on whether the retailers are Illinois retailers, retailers maintaining places of business in Illinois, or simply out-of-State retailers. An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill.

Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

If businesses register with Illinois as retailers, they are required to file returns for every return period. See 86 Ill. Adm. Code 130.545.

Regarding Questions 10 and 11: Please see, 2 Ill. Adm. Code Part 1200 for information regarding private letter rulings and general information letters.

Regarding Question 12: Divisional corporate entities may receive separate registration numbers and if they do, must then file returns separately.

Regarding Question 13: Illinois provides a credit against Illinois Use Tax liability for sales taxes properly paid and due to another state. See 150.310(a)(3).

Regarding Question 14: Illinois allows the use of blanket sales and use tax exemption certificates. A Certificate of Resale that does not contain the purchaser's Illinois registration or resale number valid on the date the certificate was issued creates a rebuttable presumption that the sale was not for resale. Taxpayers must update the certificate every three years. Please see 86 Ill. Adm. Code 130.1405 for information regarding the requirements of such certificates.

Regarding Question 15: **Drop Shipments.** The Department has adopted a regulation that specifically addresses drop shipments. See 86 Ill. Adm. Code 130.225.

Regarding Question 16: **Nexus.** For discussion on nexus please see the answer to Question 9 above.

Regarding Question 17: The State of Illinois can use statistical sampling in arriving at an audit assessment even where records exist that are adequate to perform a detailed audit. Taxpayers do not have to consent to the use of statistical sampling. Illinois generally does not assess taxpayers for costs incurred in conducting out-of-State audits.

Regarding Question 18: Illinois does not have a nexus questionnaire or a "nexus team".

Regarding Question 19: Please see the discussion on nexus in Question 9 above and 86 Ill. Adm. Code 150.201(i).

Regarding Question 20: See 86 Ill. Adm. Code 270.115 which is the regulation regarding Jurisdictional Questions related to the Home Rule Municipal Retailers' Occupation Tax. As you will note, it is the Department's opinion that the sellers' acceptance of the purchase orders or other contracting action in the making of sales contracts is the most important single factor in the occupation of selling. If purchase orders are accepted at the sellers' place of business within the municipality, the sale is at retail, and the purchasers receive physical possession of the property in Illinois, the sellers incur Home Rule Municipal Retailers' Occupation Tax liability in that home rule municipality.

If purchase orders are accepted outside this State, but the tangible personal property which is sold is in an inventory of the retailers located within a Home Rule municipality at the time of its sale, or is subsequently produced in the Home Rule municipality, then delivered to the purchasers in Illinois, the place where the property was located at the time of the sale, or at the time it was subsequently produced, will determine where the seller is engaged in business for Home Rule Municipal Retailers' Occupation Tax purposes regarding that sale. When the purchase orders are not accepted in Illinois, nor is the property located in the inventory of the retailer in Illinois at the time of the sale or when it is subsequently produced, the transactions will not be subject to Home Rule tax. The transactions will, however, be subject to Illinois Use Tax, which sellers having a physical presence in this State must collect and remit.

The Retailers' Occupation Tax and the Use Tax are based upon gross receipts. See 86 Ill. Adm. Code 130.401(a).

Regarding Question 21: If taxpayers pay amounts of taxes under the Retailers' Occupation Tax Act that are not due, either as a result of a mistake of fact or an error of law, the taxpayers may file claims for credit with the Department using Form ST-1-X. No credit shall be given the taxpayers unless they show that they have borne the burden of the tax or have unconditionally repaid the amount of the tax to the vendees from whom it was collected. See 86 Ill. Adm. Code 130.1501. The claims for credit must be prepared and filed upon forms provided by the Department containing the information listed in Section 130.1501(b). Taxpayers should not make adjustments on their next return or amend the return for the period in which the overpayment occurred.

The statute of limitations for filing claims for credit is described in Section 130.1501(a)(4). The language is somewhat confusing but, boiled down, it means that the statute of limitations is 3 to 3 1/2 years and expires in 6 month blocks. For example, on July 1, 1998, the statute of limitations expired for claims to recover taxes that were erroneously paid in the first 6 months of 1995.

Section 6 of the Retailers' Occupation Tax Act, 35 ILCS 120/6, provides that an agreement to extend the time period to issue a notice of tax liability extends to the same extent the period for filing claims for credit or refund.

Regarding Question 22: Illinois currently does not enter into sales and use tax compliance agreements.

Regarding Question 23: The State of Illinois was considered a "participating state" by the Streamlined Sales Tax Project. The State is currently classified as an "Implementing State." Illinois

has not enacted any of the substantive provisions of the Streamlined Sales and Use Tax Agreement. No SSTP compliance legislation is currently pending.

Regarding Question 24: P.A. 93-0026 created the Tax Delinquency Amnesty Act. The Act requires that the Department of Revenue establish an amnesty program applicable to all Illinois taxes collected by the Department. The amnesty program is for the period from October 1, 2003 through November 15, 2003, and applies to all eligible taxes due from the taxpayer with respect to any taxable period ending after June 30, 1983 and prior to July 1, 2002. See P.A. 93-0026.

Regarding Question 25: Illinois does not currently provide for sales tax holidays.

Regarding Question 26: Illinois does not require payment of the tax before an appeal can progress to an independent hearing body. However, Section 12 of the Retailers' Occupation Tax Act, 35 ILCS 120/12 states as follows:

Any person filing an action under the Administrative Review Law to review a final assessment issued by the Department under this Act shall, within 20 days after filing the complaint, file a bond with good and sufficient surety or sureties residing in this State or licensed to do business in this State or, instead of the bond, obtain an order from the court imposing a lien upon the plaintiff's property as hereinafter provided ...

The amount of such bond shall be fixed and approved by the court, but shall not be less than the amount of the tax and penalty claimed to be due by the Department in its final assessment or revised final assessment to the person filing such bond, plus the amount of interest due from such person to the Department at the time when the Department issued its final assessment to such person.

B. Sales and Use Tax Base

Regarding Questions 1 and 2: See 86 Ill. Adm. Code 130.101. All tangible personal property sold at retail in Illinois is subject to tax unless a specific exemption applies. Please see 86 Ill. Adm. Code 140.101 for information regarding Service Occupation Tax.

Regarding Question 3: In general, a donor who purchases tangible personal property and gives it away in Illinois makes a taxable use of the property when making the gift. See 86 Ill. Adm. Code 150.305(c). When such a gift is made, donees incur no Use Tax liability, even if they then give the item to a third person.

Please be advised these principles also apply when the donor is a business that manufactures the tangible personal property. In that situation, the donor/manufacturer incurs Illinois Use Tax liability based on its cost of materials used to manufacture the tangible personal property. However, where the donor is also a retailer, and purports to give away certain property along with other tangible personal property for which a charge is made, the "donor" is not liable for Use Tax because its purchase of such property is not for use or consumption, but for resale. See 86 Ill. Adm. Code 130.2160.

Note that the Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. The tax is measured by the seller's gross receipts from such sales made in the course of such business. See 86 Ill. Adm. Code 130.101. The term "gross receipts" means all the consideration actually received by the seller, except traded-in tangible personal property. See 86 Ill. Adm. Code 130.401.

Regarding Question 4: For information on whether taxes are included in the amount subject to tax, please see Sections 130.435 and 130.445. For information on carrying charges and retailer's own coupons, see Section 130.420. For information regarding coupons and discounts, see Section 130.2125. For information on delivery/shipping charges, see Section 130.415. For information regarding installation charges see Section 130.450. Section 130.410 provides information regarding labor, service and personnel training costs. Section 130.401 provides information regarding trade-in allowances.

Regarding Question 5: Please see the following regulatory sections for information on the following: production machinery - Section 130.330; pollution control equipment - Section 130.335; agricultural equipment - Section 130.305; Direct materials, consumed or not consumed in producing the final product - Section 130.210; packaging - Section 130.2070; isolated and casual sales - Section 130.110. Effective July 1, 2003, P.A. 93-0024 repealed a number of the exemptions from Retailers' Occupation Tax and Use Tax, including the exemption for pollution control facilities, and other exemptions. See Department of Revenue Informational Bulletin FY 2004-04.

Regarding Question 6: Please see Section 130.330(c)(2) which states that machinery and equipment used for in-house manufacture of exempt machinery and equipment is exempt. Note that the machinery must be used primarily in the manufacturing or assembling of tangible personal property for sale or lease in order to qualify.

Regarding Question 7: Illinois Retailers' Occupation Tax and Use Tax are imposed upon the sale at retail of tangible personal property, unless an exemption exists. If tangible personal property is not transferred, there is no tax liability.

Regarding Question 8: Please see 86 Ill. Adm. Code 130.1935, "Computer Software," which governs the taxability of computer software and software license agreements. As the regulation provides, the sale of canned computer software is a taxable retail sale. The sale of custom computer programs or software that is prepared to the special order of the customer is not taxable.

Regarding Question 9: **The Internet.** Retailers' Occupation Tax and Use Tax only apply to the transfer of tangible personal property. If no tangible personal property is transferred, no tax liability is incurred. Telecommunications Excise Tax may apply however. Please see discussion under Question 9 in the Compliance and Administration part of this response for information on nexus in Illinois. In regards to the Internet access, please note that the Telecommunications Excise Tax Act imposes a tax on the act or privilege of originating or receiving intrastate or interstate telecommunications by persons in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers by such persons, 35 ILCS 630/3 and 4. The Act defines gross charges as including amounts paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by retailers, 35 ILCS 630/2(a).

The taxability of charges for Internet access or usage is fact specific. Section 2(c) of the Telecommunications Excise Tax Act defines "telecommunications" and states that this term does not include "value added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission." For example, the charges for computer data, protocol conversions which permit computers to exchange data, no matter which languages or protocols a computer's output may be in, and packet-switching, which groups data into packets for efficiency of transmission, would be exempt. See 86 Ill. Adm. Code 495.100(d).

Persons that provide customers access to the Internet and who do not, as part of that service, charge customers for the line or other transmission charges which are used to obtain access to the

Internet, are not considered to be telecommunications retailers for providing such access. However, if Internet Service Providers (ISPs) charge customers fees for line charges, such fees will be subject to the tax and providers will have to register as telecommunications retailers. If retailers charge for the transmission of data, as well as for the data itself, Section 495.100(c) of the Telecommunications Excise Tax regulations provides that charges for the data processing or inquiry would not be subject to tax, but charges for transmission of the data would be taxable, so long as the charges for each is disaggregated and separately identified in the books and records of the retailer. If these charges for transmission and data services are not thus disaggregated, the entire charge is taxable as a sale of telecommunications.

Regarding Question 10: Please see 86 Ill. Adm. Code 130.1935 regarding sales of software and associated transactions. Note that if no tangible personal property is transferred in the sale of service, no tax liability is incurred. Some of the services listed may be subject to either Retailers' Occupation Tax or Service Occupation Tax depending upon the nature of the transaction. We cannot provide more guidance due to the limited amount of information provided.

Regarding Question 11: **Master Copies.** When persons produce and assemble master tapes for sale, they will be subject to the Retailers' Occupation Tax if the tapes are of a stock or standard nature, as would be the case with mass-produced commercial videos, or videos which, although produced according to prescribed specifications, may be sold to the public. When a special order or custom video is produced, Service Occupation Tax will be due upon sale. If the tapes are produced for the exclusive use of a particular customer and hold no utility to another party, they will be considered custom. Therefore, they will be subject to Service Occupation Tax instead of Retailers' Occupation Tax. Any tangible personal property (such as video or audio tape or disks) used in this State will be subject to Use Tax liability on the cost price of that property. Please note that canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See 86 Ill. Adm. Code 130.1935. Master copies of software are treated in the same manner as sales of canned or custom computer software and licenses of computer software. See Section 130.1935.

Regarding Question 12: **Maintenance and warranty contracts.** The taxability of service contracts or maintenance agreements depends upon if the charges for those agreements are included in the selling prices of the tangible personal property. If such charges are included in the selling price, those charges are part of the gross receipts of the retail transactions and are subject to tax. If this is the case, no tax is incurred on the maintenance services or parts when the repairs or servicing is performed.

Alternatively, persons may sell service contracts or maintenance agreements as separate agreements for predetermined fees. In these transactions, the proceeds from the sale of such contracts or agreements are not subject to tax. However, servicemen who provide service under the separate maintenance agreements or service contracts incur Use Tax liability based on their cost price of the tangible personal property transferred incident to the completion of the maintenance agreements. See 86 Ill. Adm. Code 140.301(3)(b). Further, the purchaser of the separate agreement or warranty is not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance agreement.

Computer software maintenance agreements are treated in the same manner as for other maintenance agreements. See 86 Ill. Adm. Code 130.1935(b). If the maintenance agreement provides for updates of canned software and those upgrades are not separately stated and taxed, the entire maintenance agreement is taxable as a sale of canned software.

Regarding Question 13: **Leases.** Except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq., the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. Please note that Illinois provides exemptions regarding certain property leased to exempt hospitals and governmental entities. See 86 Ill. Adm. Code 130.2011 and 130.2012. Please also note that those exemptions regarding certain leases to exempt hospitals and governmental entities were sunsetted on January 1, 2001 and re-imposed on August 2, 2001. Therefore, those exemptions were not available for the period January 1, 2001 through August 1, 2001.

For Illinois sales tax purposes, there are two types of leasing situations: true leases and conditional sales. A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3).

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

Regarding Question 14: **Donations.** The donation of tangible personal property to a charity, or to anyone else, is not considered to be a transfer for consideration, and does not result in a Retailers' Occupation Tax liability to the donor. However, donors, including those making donations to charities, incur a Use Tax liability based on their cost price of the items donated. A transfer of non-inventory property could possibly trigger a Use Tax liability if the donor of the property had not already paid tax. See 86 Ill. Adm. Code 150.305(c). Please note that special rules apply to donations for disaster relief. See 130.120(ii).

Regarding Question 15: **Contractors.** In Illinois, construction contractors are deemed to be the users of the tangible personal property they purchase for physical incorporation into real estate. For that reason, they incur a Use Tax liability on their cost price of those building materials. See 130.2075(a)(2)

Construction contractors incur no sales tax liability on their receipts from labor furnished in the performance of construction contracts. See 130.1940(c)

Contractors can purchase building materials tax-free when those materials will be incorporated into real estate owned by an entity which has been issued an Illinois sales tax exemption identification number. See 130.2075(d). The purchasing contractor must give suppliers the certification described at 130.2075(d)(4).

Regarding Question 16: So long as the construction contractor incorporates tangible personal property into real property under a construction contract agreement, the contractor is not responsible for Retailers' Occupation Tax. In this situation, no gross receipts tax is imposed in addition to the contractors' Use Tax liability.

Regarding Question 17: A contractor that is incorporating tangible personal property into real property under a construction contract agreement would not use or accept a Certificate of Resale. See the answer to Question 15 above.

Regarding Question 18: Gas and electricity are not subject to the Retailers' Occupation Tax and Use Tax. Please note that gas is taxed under the Gas Revenue Tax Act (35 ILCS 615). The Department follows Illinois Attorney General Opinion 95-001 in applying the Gas Revenue Tax to interstate sales of gas for use or consumption. This opinion relies upon an Illinois Supreme Court Case, Mississippi River Fuel Corp. v. Hoffman (1955), 4 Ill 2d 459. In this case, the court held that the Gas Revenue Tax Act did not impose a tax upon the owner/operator of an interstate gas pipeline with respect to its gross receipts from sales of gas for use or consumption in Illinois. However, effective October 1, 2003, Illinois will impose a Gas Use Tax. The Gas Use Tax is imposed on the privilege of using in Illinois gas obtained in a purchase of out of state gas. A "purchase of out-of-state gas" is specifically defined to mean a transaction for the purchase of gas from any supplier in a manner that does not subject the seller of that gas to liability under the Gas Revenue Tax Act. See Public Act 93-0031.

As of August 1, 1998, due to deregulation of electric utilities in Illinois, electricity will be taxed under the Electricity Excise Tax Law (35 ILCS 640). The legal incidence of this tax is upon the consumer. The last delivering supplier collects this tax.

Regarding Question 19: **Prepaid Phone Cards (PPCs).**

Beginning January 1, 2001, prepaid telephone calling card arrangements are exempt from Telecommunications Excise Tax liability and instead are taxed as tangible personal property under the Retailers' Occupation Tax Act, Service Occupation Tax Act, Service Use Tax Act, and Use Tax Act.

Prior to January 1, 2001, sales of telephone cards by retailers were not subject to Retailers' Occupation Tax. However, the Telecommunications Excise Tax consequences from sales of cards by retailers may vary depending upon whether we would deem the retail stores to be retailers of telecommunications. Please see 86 Ill. Adm. Code Part 495.

In some cases prior to January 1, 2001, retail stores had purchased telephone cards from telephone service providers and then sold the cards to customers at marked-up prices. In this scenario, we did not consider the retail stores to be retailers of telecommunications. In that case, the retail store was not responsible for collecting Telecommunications Excise Tax at the point of sale of the card to its customer or at any other point. The tax was incurred at the time the telecommunications originated or were received in a taxable manner, and the amount of telecommunications charges for which the cards were redeemed by the telephone service providers included any amount of Telecommunications Excise Tax incurred. The telephone service providers

charged the phone calls and the tax against the balance of the cards since they were responsible for collecting and remitting the tax.

However, in other cases prior to January 1, 2001, the stores may have purchased telecommunications units from telephone service providers and sold them at retail to their customers. That situation was similar to hotels that sell telecommunications services. See section 495.110. In those cases, the retail stores were required to register as telecommunications retailers and collect and remit Telecommunications Excise Tax. The tax base was the amount charged to card purchasers for the taxable services subsequently provided (i.e. calls that originated or terminated in Illinois). In those situations, retail stores had the burden to establish that charges were exempt from the Telecommunications Excise Tax. The only way to document this was through the records of the telephone service providers. Therefore, as a practical matter, because retail stores did not know at the time the sales were made what taxable services cardholders would later consume, the retail stores were required to charge the tax on the full sales prices of the cards.

Sales of prepaid telephone calling card arrangements through automated teller machines (ATMs) are taxed in the same manner as sales through traditional retail establishments. Generally, the providing of a PIN number or other authorization code would be sufficient to constitute the sale of a prepaid telephone calling card arrangement. See 35 ILCS 120/2-27. The telecommunications provider would not be subject to tax in such arrangements. The ATM provider (or other related entity making the actual sale to the customer) would be liable for the tax as described above.

Regarding Question 20: **Electronic Data Interchange.** Illinois sales tax rules provide that taxpayers may utilize electronic data interchange (EDI) as a method for record keeping if the EDI process contains the level of record detail, in combination with other records related to the transaction, that is equivalent to the level of detail contained in an acceptable paper record. See 86 Ill. Adm. Code 130.805. Please note that hard copy records generated at the time of the transaction need not be retained unless those hard copy records are required to be provided or received under current Illinois statutes or rules. See subsection (d) of Section 130.805. Illinois statutes and rules do not currently provide for record keeping using Evaluated Receipts Systems (ERS). Illinois has incorporated, with minor modifications, the model record keeping and retention regulation into its current record keeping rules.

Regarding Question 21: **Procurement Cards.** The Department has no specific rules regarding procurement cards. The following information discusses when a sale is deemed to be made for jurisdictional purposes and applies to all sales in Illinois. Please see 86 Ill. Adm. Code 270.115 which is the regulation regarding Jurisdictional Questions related to the Home Rule Municipal Retailers' Occupation Tax. It is the Department's opinion that the sellers' acceptance of the purchase orders or other contracting action in the making of the sales contract is the most important single factor in the occupation of selling. If purchase orders are accepted at the sellers' place of business within the municipality, the sale is at retail, and the purchasers receive physical possession of the property in Illinois, the sellers incur Home Rule Municipal Retailers' Occupation Tax liability in that home rule municipality.

If purchase orders are accepted outside this State, but the tangible personal property which is sold is in an inventory of the retailers located within a Home Rule municipality at the time of its sale, or is subsequently produced in the Home Rule municipality, then delivered to the purchasers in Illinois, the place where the property was located at the time of the sale, or at the time it was subsequently produced, will determine where the seller is engaged in business for Home Rule Municipal Retailers' Occupation Tax purposes regarding that sale.

When the purchase orders are not accepted in Illinois, nor is the property located in the retailer's inventory in Illinois at the time of the sale or when it is subsequently produced, the transactions will not be subject to Home Rule tax. The transactions will, however, be subject to Illinois Use Tax, which sellers having a physical presence in this State must collect and remit.

For audit purposes, the Department looks for the same level of detail from procurement card statements that is contained in a traditional paper invoice.

Regarding Question 22: **Sales/Use Tax Filing Requirements Single-Member LLCs.** Every person engaged in making retail sales in Illinois must register and obtain a Certificate of Registration from the Department. See 86 Ill. Adm. Code 130.701. Each taxpayer is registered with an individual Illinois Business Tax number (IBT number) for sales and use tax reporting.

The Illinois Retailers' Occupation Tax Act defines a "person" as "any natural individual, firm, partnership, association, joint stock company, joint adventure, public or private corporation, limited liability company, or a receiver, executor, trustee, guardian or other representative appointed by order of any court." 35 ILCS 120/1 (1996 State Bar Edition). Any limited liability corporation or other entity that is making retail sales subject to the Retailers' Occupation Tax Act or Use Tax Act must be separately registered with its own IBT number and must file returns under that number.

Regarding Question 23: **Sales/Use Tax Filing Requirements QSSSs.** See the answer to question 22 above.

Regarding Question 24: **Taxation of Printers.** See 86 Ill. Adm. Code 130.325, regarding the Graphic Arts Machinery and Equipment Exemption. Under this exemption, machinery and equipment used primarily in graphic arts production may be sold tax-free. However, effective July 1, 2003, the exemption for graphic arts machinery and equipment is repealed. See Public Act 93-0024. Please note that Illinois has a separate exemption for manufacturing machinery and equipment and graphic arts machinery and equipment will not qualify for the manufacturing machinery and equipment exemption. See 86 Ill. Adm. Code 130.330.

The Service Occupation Tax Act applies to servicemen engaged in graphic arts production when they produce custom printed items. See 86 Ill. Adm. Code 140.101. They will incur either a Service Occupation Tax or Use Tax liability, depending upon the tax base chosen under the Service Occupation Tax Act. See 86 Ill. Adm. Code 140.105. The resale exemption may be available for tangible personal property transferred to service customers, based upon this choice. See 86 Ill. Adm. Code 130.1401 and 130.1405. However, servicemen that handle their tax liability as provided in 86 Ill. Adm. Code 140.108 cannot purchase tangible personal property for resale, but must pay Use Tax on the tangible personal property that is transferred incident to sales of service.

Until recently, "graphic arts production" was defined as printing by one or more of the common processes of printing or graphic arts production services as those processes and services are defined in Major Group 27 of the U.S. Standard Industrial Classification Manual. These types of common processes of printing include printing such as by letterpress, lithography, gravure, screen, engraving, and flexography. Print trade services such as typesetting, negative production, plate production, bookbinding, finishing, and loose-leaf binder production are examples of services which are included in the definition of graphic arts production.

However, Public Act 91-541 was signed into law on August 13, 1999. This Act updated the graphic arts exemption by incorporating the North American Industry Classification System published by the U.S. Office of Management and Budget, 1997 edition instead of the U.S. Standard Industrial Classification Manual. The Act amended the definition of "graphic arts production" to mean "printing,

including ink jet printing, by one or more of the processes described in Groups 323110 through 323122 of Subsector 323, Groups 511110 through 511199 of Subsector 511, and Group 512230 of Subsector 512 of the North American Industry Classification System published by the U.S. Office of Management and Budget, 1997 edition. Graphic arts production does not include (i) the transfer of images onto paper or other tangible personal property by means of photocopying or (ii) final printed products in electronic or audio form, including the production of software or audio-books.” Groups 323114 and 323115 of the North American Industry Classification System include quick printing and digital printing processes. See subsection (b) of 86 Ill. Adm. Code 130.325.

Consumable supplies, such as, film and chemicals used to clean plates and presses, are generally purchased for use and do not qualify for the resale exemption. It is our understanding that film, once exposed, retains the image permanently. While the resulting image may be used multiple times, the film is still a consumable supply.

Regarding Question 25: **Distribution of catalogs and other promotional materials.** Illinois treats the giving away of catalogs and other promotional materials similar to a gift situation. Service Use Tax liability may be incurred by donors in these situations. The application of Service Occupation Tax and Service Use Tax to these transactions is extremely fact dependent. Please note that if the use occurs outside of this State, then no tax would be incurred.

Regarding Question 26: **Common and Contract Carriers.** The Illinois Retailers' Occupation Tax and Use Tax do not apply to sales of tangible personal property to interstate carriers for hire for use as rolling stock moving in interstate commerce. See 86 Ill. Adm. Code 130.340. The exemption applies to sales of tangible personal property to lessors under leases of one year or longer executed or in effect at the time of purchase with interstate carriers for hire for use as rolling stock moving in interstate commerce. A lessor will not incur Use Tax on the purchase of the vehicle that is leased to the interstate carrier for hire for use as rolling stock moving in interstate commerce under a lease term of one year or longer. See 35 ILCS 105/3-55(b) and 120/2-5(12). If a lessor leases a vehicle to an interstate carrier for hire under a lease term of less than one year, the rolling stock exemption is also available because the tax does not apply to the use by (or sale to) lessors, owners, or shippers of tangible personal property that is utilized by interstate carriers for hire for use as rolling stock moving in interstate commerce. See 35 ILCS 105/3-55(c) and 120/2-5(13).

From August 14, 1999, through June 30, 2003 motor vehicles, trailers, and property attached to those motor vehicles and trailers must carry persons or property for hire in interstate commerce on 15 or more occasions within a 12- month period to qualify for the exemption. See 35 ILCS 120/2-51; and 86 Ill. Adm. Code 130.340(e). On and after July 1, 2003, motor vehicles not subject to the commercial distribution fee exemption, and replacement and repair parts for motor vehicles, qualify for the exemption provided that the vehicle is used to carry persons or property in interstate commerce for hire for 51% of its total trips during each 12-month period. On and after July 1, 2003, trailers and repair and replacement parts for trailers qualify for the exemption provided the trailer is used to carry property for hire in interstate commerce on a regular and frequent basis. See 86 Ill. Adm. Code 130.340(g). For other types of property used in interstate commerce, the interstate carriers must be able to show, from their books and records, that the property has moved in interstate commerce for hire on a regular and frequent basis in order to qualify for the exemption.

Purchasers also must be recognized by the appropriate federal or state regulatory agency as interstate carriers for hire and have received a Certificate of Authority to engage in interstate commerce. Please note that it is not the type of item that determines whether or not it qualifies as rolling stock, but rather how a qualifying interstate carrier uses the item. In addition to receiving the proper Certificate of Authority, purchasers should be aware that only those items used specifically as rolling stock would qualify. See 86 Ill. Adm. Code 130.340.

Beginning July 1, 2003, Public Act 93-0023, Retailers' Occupation Tax and Use Tax do not apply to the sale/purchase of certain motor vehicles (including repair and replacement parts) subject to the commercial distribution fee imposed under Section 3-815.1 of the Illinois Vehicle Code. See Department of Revenue Informational Bulletin FY 2004-07.

Regarding Question 27: **Shipping Containers and Materials.** The sale of containers, as that term is defined in Section 130.2070(a) of the Department's rules, is not subject to Retailers' Occupation Tax when the purchasers of such containers transfer to customers the ownership of the containers together with what is contained in them. See 86 Ill. Adm. Code 130.2070. For example, purchases of packing materials or containers are nontaxable as long as they are transferred along with the products contained in them to customers. Purchasers buying containers for this type of use are considered to be making tax-free purchases for resale purposes. However, please note that such materials would not qualify for the exemption if, after delivery, the seller of the tangible personal property contained in them retained and reused them or discarded them.

Regarding Question 28: **Freight and Shipping Charges.** Generally, no deductions shall be made by a taxpayer from gross receipts or selling prices on account of the cost of property sold, the cost of materials used, labor or service costs, freight or transportation costs, overhead costs, clerk hire or salesmen's commissions, interest paid by the seller, or any other expenses whatsoever. See 86 Ill. Adm. Code 130.410. However, charges designated as delivery or transportation charges are not taxable if it can be shown that they are both agreed to separately from the selling price of the tangible personal property which is sold and that such charges are actually reflective of the costs of shipping. See 86 Ill. Adm. Code 130.415. In these circumstances, to the extent that shipping and handling charges exceed the costs of shipping, the excess charges are subject to tax. The best evidence that transportation or delivery charges are agreed to separately and apart from the selling price, is a separate and distinct contract for transportation or delivery. See subsection (d) of Section 130.415.

Regarding Question 29: We cannot answer your question regarding a "managed audit program or similar program" without more information regarding exactly what type of program you are referring to.

Regarding Question 30: Retailers and manufacturers who withdraw tangible personal property from inventory for use as samples to be given away, for research and development, and for display or demonstration owe Use Tax on the cost price of that property. For example, the cost price for manufacturers does not include any labor or other component of cost other than their cost of materials. However, except with respect to certain watercraft or aircraft, in general, tangible personal property purchased for resale and used by its owner for demonstration purposes is not subject to Use Tax. 86 Ill. Adm. Code 150.306(b)(1). The same is true with respect to tangible personal property purchased for resale, but used prior to such resale, provided that the property remains inventory on the retailer's books or is otherwise available for sale during such interim use. 86 Ill. Adm. Code 150.306(a)(1).

Regarding Questions 31 through 33: Illinois does not impose sales or use taxes on services. Illinois does tax tangible personal property transferred incident to sales of service. Please see 86 Ill. Adm. Code 140.101 for information regarding Service Occupation Tax.

Regarding Question 34: Airplanes, automobiles, and watercraft are taxed in the same manner as other types of tangible personal property under the Retailers' Occupation Tax Act. However, the sale of these items (and other tangible personal property that is required to be registered with an

agency of this State's government) are reported on transaction reporting returns. Please see 86 Ill. Adm. Code 130.540. State-level taxes are imposed on those sales based upon the "point of purchase" or location of purchase order acceptance. See the previous answer to Question 20 on page 7 of this letter. No special rates, caps, or thresholds are applied to such purchases under the Retailers' Occupation Tax Act.

Local governments are allowed to impose a use tax on tangible personal property that is required to be registered with an agency of this State's government and that is registered to an address within the jurisdictional boundaries of those local governments. See for example the Home Rule County Use Tax authorized under 55 ILCS 5/5-1008 which can be imposed in ¼ percent increments and which is collected directly by the counties imposing those taxes.

Illinois also imposes a vehicle use tax on vehicles acquired by gift, transfer, or purchase (other than from a retailer). The tax rate is imposed in brackets for vehicles with selling prices of \$15,000 and above. For vehicles with selling prices below \$15,000, the tax is based on the model year of the vehicle. See 625 ILCS 5/3-1001 et seq.

In addition, beginning July 1, 2003, Illinois imposes an Aircraft Use Tax. The tax is imposed on the privilege of using in Illinois any aircraft acquired by gift, donation, transfer, or non-retail purchase. Public Act 93-0024. Finally, beginning July 1, 2003, a person engaged in the business of renting aircraft incurs Retailers' Occupation Tax on retail sales of aircraft used in such business. Public Act 93-0024. See also Department of Revenue Informational Bulletin FY 2004-06.

Regarding Question 35: Department of Revenue Regulations Section 130.2076 discusses sales of tangible personal property to government contractors. The section provides that, in general, sales to a government contractor in order for the contractor to fulfill its obligations under the contract are considered sales for use or consumption. Accordingly, such sales are retail sales subject to Retailers' Occupation Tax and Use Tax. The Section goes on to provide, however, that if the contract with the governmental unit explicitly requires the contractor to sell the items of tangible personal property to the governmental unit, and other requirements of the section are satisfied, such sales may be considered sales for resale not subject to Retailers Occupation Tax or Use Tax.

Regarding Question 36: See answer to questions 31-33.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Brian Stocker
Associate Counsel

BS:msk